No. 9812

In the United States

Circuit Court of Appeals

For the Ninth Circuit

L. B. HIRSCH and MAX S. and CLEMENTINE HIRSCH,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

Brief of Petitioners

Upon Petition to Review Decisions of the United States Board of Tax Appeals

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SUBJECT INDEX

TABLE OF CASES

STATUTES

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BRIEF OF PETITIONERS

Upon Petition to Review Decisions of the United States Board of Tax Appeals

OPINION OF BOARD

The opinion and findings of the United States Board of Tax Appeals is reported in *42 BTA No. 87.* (Tr. 42.)

JURISDICTION

This appeal involves additional income taxes for petitioners, Max S. and Clementine Hirsch, for the year 1935 in the amount of $9340.78, and additional income taxes for the petitioner, L. B. Hirsch, for the year 1935 in the amount of $1174.60, and for the year 1936 in the amount of $174.79, found by the United States Board of Tax Appeals to be due as deficiencies by an order entered on September 19, 1940. (Tr. 70-71) The appeal was taken by petition filed with the Board on December 16, 1940. (Tr. 79) Jurisdiction to review the order is conferred upon this court by *Section 1001, Revenue Act of 1926*, as amended by *Section 603, Act of 1928*, and Section 1101, Act of 1932.

QUESTIONS PRESENTED

The questions and issues are:

(1) Whether there is substantial evidence to support the finding of the Board that the transaction consummated in December, 1935, between the petitioners and the Hirsch-Weis Manufacturing Company whereby the corporation redeemed a portion of its capital stock in cancellation of the indebtedness of the petitioners who were stockholders and officers of the corporation, was essentially equivalent to a taxable dividend, in lieu of finding and determining that the transaction under the facts and circumstances was a sale and purchase and by reason thereof that there was no deficiency in the income tax return of said petitioners for said year.

(2) Whether there is substantial evidence to support the finding of the Board that one of the peti-

tioners, Max S. Hirsch, is not entitled to a bad debt deduction in the year 1935 in respect of a loan by said petitioner made to his brother-in-law in a prior year, in lieu of a finding that the petitioner was entitled to such a deduction.

(3) Whether there is substantial evidence to support the finding of the Board that the petitioner, L. B. Hirsch, is not entitled to an exemption of $2500.00 as head of a family and credits of $1200.00 for three dependents for the years 1935 and 1936 in lieu of a finding that said petitioner was entitled to such exemption.

STATUTES INVOLVED

Revenue Act of 1934 (48 Stat. 680, ch. 277) Section 115 (g), (26 U.S.C. 115)

"Sec. 115. Distributions by Corporations.

* * * * * * * *

"(g) Redemption of stock—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend."

Deductions from Gross Income: Bad Debts.

Sec. 23 (Internal Revenue Code). In computing net income there shall be allowed as deductions:

* * * * * * * *

(k) Bad Debts.

(1) General Rule—Debts ascertained to be worthless and charged off within the taxable year . . .

* * * * * * * *

Reg. 103, Sec. 19.23 (k)—1. Bad Debts—(a) bad debts may be treated in either of two ways—

(1) By a deduction from income in respect of debts ascertained to be worthless in whole or in part,

Section 25(b) (1) and (2), (26 U.S.C. 25).

"Sec. 25. Credits of Individual Against Net Income.

* * * * * * * *

"(b) Credits for both normal tax and surtax —There shall be allowed for the purposes of the normal tax and the surtax the following credits against net income:

"(1) Personal exemption—In the case of a single person, a personal exemption of $1,000; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,500. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $2,500. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them.

> "(2) Credit for Dependents—$400 for each person (other than husband and wife), dependent upon and receiving his chief support from the taxpayer if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective."

SPECIFICATIONS OF ERRORS

The petitioners contend that the Board erred:

(1) In failing to hold that the transaction between the petitioners and the Hirsch-Weis Manufacturing Company, whereby the petitioners transferred a number of shares of stock owned by them respectively to the corporation in liquidation of their respective indebtedness, was a sale and purchase of said stock.

(2) In holding and finding that the transaction consummated in 1935 between the petitioners and the Hirsch-Weis Manufacturing Company, by which they liquidated their respective indebtedness was "essentially equivalent to a dividend," and determining a deficiency for the income tax return for the year 1935 against the said petitioners in lieu of finding and determining that there was no deficiency in the income tax return of said petitioners for said year.

(3) In finding that the stockholders, other than Max S. Hirsch and L. B. Hirsch, were, in 1935, given the privilege of retiring 10 per cent of their holdings at $100.00 per share.

(4) In failing to find that the retirement of the indebtedness of L. B. Hirsch and Max S. Hirsch on December 31, 1935, was retired because of the requirements of the corporation's brokers.

(5) In failing to find and hold that the petitioner, Max S. Hirsch, sustained a deductible loss in the year 1935 by reason of his loan to Leo W. Seller, and in failing to allow as a deductible loss the sum of $9,400.00 for the year 1935, representing the Seller loss from the income tax return of the petitioner for the year 1935.

(6) In finding and holding that Leo W. Seller had no property in either year 1934 or 1935 out of which his indebtedness to Max S. Hirsch might have been paid.

(7) In failing to hold that the petitioner, L. B. Hirsch, was entitled to an exemption as head of the household, and in failing to allow the said petitioner a personal exemption as head of the household for the year 1935 and 1936.

(8) In failing to hold that there was no deficiency in the petitioners' income tax returns for the year 1935 and 1936 on account of these items.

STATEMENT OF FACTS AS TO ISSUE I.

The facts which the petitioners deem germane to a discussion of the issues involved will be set forth only so far as necessary, and are as follows:

The petitioners, Max S. and Clementine Hirsch, are husband and wife and filed joint income tax returns for 1935 and 1936. The petitioners, L. B. Hirsch is a brother of Max S. Hirsch, all residing in the City of Portland, Oregon.

The Hirsch-Weis Manufacturing Company was organized under the laws of the State of Oregon in 1912, with an authorized capital stock of $100,000 divided into 1000 shares of common stock of the par value of $100.00 each. The corporation was engaged in the business of manufacturing and selling work clothes, canvas materials and related products, with its principal place of business in the City of Portland, Oregon, and the petitioners, Max S. Hirsch and L. B. Hirsch, during 1935 and 1936 were President and Vice-President respectively of the corporation. Of the original stock issue, Max S. Hirsch subscribed and paid for 600 shares, L. B. Hirsch, 160 shares, Clara Behrens, a sister of Max S. and L. B. Hirsch, 40 shares, H. A. Weis, 100 shares, and E. A. Gerst 100 shares. The Board of Directors of the said Hirsch-Weis Manufacturing Company for some time prior, and during the years 1935 and 1936, consisted of Max S. Hirsch, L. B. Hirsch and H. A. Weis. In 1920 the authorized capital stock of the corporation was increased to $700,000 and a stock dividend of 500% was then declared and paid. The stockholders and the number of shares of stock held by each on December 21, 1920 and on December 20, 1935, were as follows:

Stockholder	Shares owned Dec. 21, 1920	Shares owned Dec. 20, 1935
Max S. Hirsch	3,600	3,600
L. B. Hirsch	960	1,000
H. A. Weis	600	634
E. A. Gerst	600	598
Clara Behrens	240	74
H. Minsch	34	34
E. Doering	12	12
H. Hirsch	7	7
Total	6,053	5,959

The petitioner, Max S. Hirsch, in addition to being President of the corporation, also acted as General Manager since the incorporation.

From 1922 to 1934 it was the practice of the petitioners, Max S. and L. B. Hirsch, to borrow substantial sums of money from the corporation for their private purposes, which loans were evidenced by notes to the company bearing interest at the rate of 6% per annum, and from time to time repaid the amounts so borrowed, together with interest to the corporation. On December 20, 1935, the petitioner, Max S. Hirsch, was indebted to the corporation in a total of $58,010.51, of which amount $41,100.00 was represented by promissory notes, $13,123.10 on open account, $1287.41 accrued interest, and $2500.00 was represented by a note of a third party which the petitioner assumed. The indebtedness of petitioner, L. B. Hirsch, to the company at the same time was $14,186.18 all of which was represented by promissory notes.

Prior to June 1934, the Hirsch-Weis Manufacturing Company borrowed from time to time as it needed for its business funds from local banks at normal interest rates of five to six per cent per annum. In 1933, however, the company began selling its commercial paper through brokers as a means of financing its business operations, and was able to secure funds at an interest rate of 1 to 1¼ per cent. The brokerage concern which was marketing the company's commercial paper prior to 1935 requested an audit of the company's books, and in 1934 such an audit of the company's books was made. After a consultation with the brokerage firm the auditors requested that as a protection to the company's financial rating, the loans of the stockholders appearing on the company's books be liquidated. To meet the terms of the brokers, so that the corporation might continue to obtain the funds with the favorable interest rate, the petitioner, Max S. Hirsch, endeavored to sell other assets and to borrow on his individual life insurance policies, but failing to obtain an amount from such borrowings sufficient to repay his indebtedness, consulted about the matter with Mr. L. B. Hirsch, the other petitioner, and H. A. Weis, the Secretary of the corporation, and at an informal meeting in the office of the company in December of 1935, it was agreed that the petitioner, Max S. Hirsch, should transfer and sell to the corporation 500 shares of the capital stock of said corporation owned by him and that the petitioner, L. B. Hirsch, would likewise sell and transfer to the corporation 100 shares of the capital stock owned by him, and that the corporation would accept same in payment of their respective indebtedness.

Accordingly on December 21, 1935, the petitioner Max S. Hirsch surrendered 500 of his shares of stock and L. B. Hirsch surrendered 100 shares of his stock at $100.00 par value in partial liquidation of their respective indebtedness. No formal minute for the records of the corporation was made on that occasion, but approximately two years after the occurrence of the transaction, Mr. H. A. Weis, a stockholder, secretary and member of the Board of Directors of the corporation, complained that he might sometime want the same privilege (if ever he became indebted to the corporation) of repaying such debt by the cancellation of a portion of his stock. What purported to be minutes of a meeting was thereupon drafted in the year 1937 dated as of December 21, 1935, and posted in the company's minute record. Such draft of minutes did not record what actually occurred.

The evidence further shows that with the single exception of 1920, when the corporation declared a stock dividend from its accumulated earnings, that whenever a dividend was declared it was paid in cash, and that from 1929 to 1935, inclusive, no dividend was declared by the corporation in any form, and for the years 1930, 1931, 1932, substantial losses were incurred. The net earnings for the year 1935 of the Hirsch-Weis Manufacturing Company were $30,654.17, whereas a cash dividend of $84,000.00 would have been required to pay petitioners' indebtedness.

ARGUMENT AND CITATION OF AUTHORITIES ON ISSUE I.

The Board's Finding that the Cancellation and Redemption of the Stock of Petitioners, Max S. and L. B. Hirsch, under the Circumstances Present Herein was Essentially Equivalent to a Taxable Dividend is Not Supported by Any Substantial Evidence and is Contrary to Law.

The first question for consideration is whether under the facts the redemption of a portion of the shares of stock of the two petitioners, Max S. and L. B. Hirsch in December, 1935, was "at such time and in such manner as to make the distribution and cancellation, or redemption in whole or in part, essentially equivalent to the distribution of a taxable dividend." It is respectfully submitted that there was no substantial evidence to sustain the finding and the ruling of the Board that under the circumstances the partial redemption constituted a redemption essentially equivalent to the distribution of a taxable dividend. On the contrary, the evidence is overwhelming that it constituted a sale for the purpose of cancelling debts due and owing from petitioners to the corporation.

We concede that decisions involving the interpretation and application of Section 115 (g) of the Revenue Code are varied and conflicting and that each case must be determined on the facts present. We respectfully submit, however, that the evidence adduced, and the record made at the trial, leads to the inevitable conclusion that the redemption was for the purpose of removing the indebtedness of the petitioners to accomplish a legitimate business purpose, namely, the continued enjoyment of favorable low interest rates on commercial loans by the Hirsch-Weis Manufacturing Company.

The facts in this case do not suggest, as they do in some of the cases decided by this Court, that the two petitioners in 1935 entered into some scheme or plan whereby their borrowings would be paid by cancellation in "form" in order to avoid a declaration of a dividend by the corporation. The practice of borrowing substantial sums of money by the petitioners from the corporation was of long standing and was evidenced by promissory notes bearing a legal banking interest of 6% per annum, and which borrowings, together with interest, were repaid in cash from time to time. Not a scintilla of evidence is presented to contradict this as the established practice of petitioners. The purpose of the redemption, we submit, was for legitimate business purposes, namely, to satisfy the brokers and enjoy a favorable low interest rate of 1% to 1¼% on the part of the corporation.

We further respectfully submit that there is no evidence whatever to show that the redemption of stock in 1935 for the purpose above stated was employed by or extended to any other stockholder. A small number of shares were purchased by the corporation from small stockholders prior to December 1935, and entirely independent of any connection with the request of the petitioners for the redemption of their stock for the cancellation of their debts in 1935.

The record shows that Elsie Doering owned 12 shares of stock, and on July 31, 1935, long before there was any discussion by the petitioners relating to the cancellation of their stock, had sold her stock to the corporation. Similarly Clara Behrens surrendered 14 shares on August 28, 1935, and in 1936 she sold to the corporation an additional 10 shares of stock, and E. A. Gerst 82 shares of stock. If it was the intention to declare a dividend in the form of a redemption of 10% of the respective holdings of all stockholders as of December 20, 1935, then Max S. Hirsch would have been entitled only to redeem 360 shares; L. B. Hirsch, 100 shares; H. A. Weis, 63.4%; E. A. Gerst, 59.8%; Clara Behrens, 7.4%; H. Minsch, 3.4%; E. Doering, 1.2%, and H. Hirsch, .7%.

It must be borne in mind that none of the other stockholders received any cash, either for stock turned in or as a dividend.

The crux of the situation herein is that two substantial stockholders and officers of the corporation were indebted to the corporation, which indebtedness was incurred over a long period of time and originated in a long established practice of borrowing and repayment; that the corporation enjoyed extremely low rates of interest on commercial borrowings, and in order to secure such money at the extremely favorable rates, it was necessary to maintain a high credit standing; that the commercial brokers objected and demanded that the loans of the stockholders and officers be liquidated and removed from the balance sheet of the corporation; that the petitioners had no other or independent means of repaying their loans to the corporation, and to meet the broker's demands the only possible recourse was to have the corporation redeem a portion of their stock in cancellation of their respective indebtedness.

It must be noted further that there could be no advantage to the Hirsches in the surrender of their stock. On the other hand, they suffered a reduction of their respective interests, with a corresponding reduction in the proportionate dividends to be received in the future. Any advantage that resulted from the transaction flowed to the corporation, and not to the petitioners. The corporation was enabled to borrow money at a very much cheaper rate.

We respectfully submit further that no extraordinary profits were present for distribution in 1935. In this case the net profits in 1935 were some $30,000 with a cash balance at the end of 1935 of only $38,000, offset by notes and accounts payable aggregating some $116,000.

It is important to point out that while there were some accumulated and undivided profits of approximately $150,000, all of these profits, with the exception of the cash and notes receivable, were in the form of inventory made up of finished and unfinished merchandise on the shelves of the corporation.

It may be suggested that the same purpose might have been obtained by a cash dividend to stockholders and the payment by the petitioners of their indebtedness to the corporation, but we respectfully submit that the cash position of the corporation would have been sufficient only to pay one-half of the amount of the indebtedness eliminated by the redemption of the stock of these petitioners, without considering the necessity of paying a dividend to the other stockholders of record, and without giving any consideration to the outstanding notes of $116,000 and the necessity for the retention of the cash for working capital.

We earnestly urge the court to consider the testimony of Mr. Van who unqualifiedly stated, "that in his judgment it would have been poor business policy to have declared a dividend in 1935." The reasons given by Mr. Van for that conclusion standing uncontradicted, compels a finding that the redemption of stock in the manner in which it was done at the time by the petitioners was for a substantial business reason, and for no other reason. We quote Mr. Van's positive testimony on direct examination:

> "Q. Now, Mr. Van, in line with the financial condition which you have now related, you, as a representative of the brokers, making commercial loans to the corporation, would you say that the corporation at the end of 1935 could have declared a dividend on their financial condition at that time?"
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> * * * * * * * *
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> "A. Frankly, I don't believe it would have been good business judgment to have declared a dividend.
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> * * * * * * * *
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> "A. I might explain that: we were employed to examine the accounts of this company at the request of the note brokers—and the accountants are usually employed in such cases because the note brokers feel that the accountants are familiar with their requirements, and naturally a great part of our responsibility in engagements of this nature is in seeing that the financial transactions of the company are handled as meticulously as possible. The financial paper market is not a market that is open to all corporations. A company, in order to qualify for the commercial paper market first must have the highest credit rating; it must have a clean financial statement;

by that I mean a statement in which the funds of the company are invested in assets pertaining to the operation of the business; it must have a high ratio of current assets to current liabilities; it must deal with its creditors in a very meticulous manner; by that I mean it must pay accounts on the due date or the discount date by discountable paper, and it should not take advantage of its creditor by paying at a date past discount date and still claim the discount. In other words, their relations must be absolutely square, and it must have a favorable earnings record; it must have a conservative quality of dividends; and it must maintain a substantial surplus account. The maintenance of a substantial surplus account being the evidence of a conservative policy as regards putting earnings back into the business and creating a favorable ratio of debts to net worth.

"On December 31, 1934, the accounts of this company showed among its assets, notes and accounts receivable from officers and employees in the sum of $54,859.44. I believe I testified on that point, as to the action we took when we discovered those advances. The earnings were known to be less in 1935 than they were in 1934. The business of the company was increasing during those years, evidencing that, if that condition continued, a need for additional money to finance the operations. That is particularly true because of the situation regarding the very large inventories. The inventory turn-over was, roughly, one and one-half times per year, which was low for that business, and unless that inventory turn-over could be improved, it was obviously necessary to provide for additional funds; and in addition, the firm had not cleared up its indebtedness to its commercial paper brokers at the end of 1934 or 1935; they still owed $85,000 at the end of the business season. Of course, commercial paper money is advanced to provide for operations of

the business during the usual seasonal operations, and the firm should be expected to, as far as possible, or, as fast as possible, provide its own capital for other than seasonal operations; *and in view of those conditions, I did not believe then, at the time of my examination, and I don't believe now that it would have been good business judgment to have declared a dividend out of the small earnings in 1935.* I think it would have left a bad impression amongst the commercial paper people and the banks who bought that paper. I might say that this account was not one of the easiest accounts to put on the market. You understand that the brokers, in taking on a line of paper, have to develop a market for that paper so that it can be sold to the banks in the territory to be used as a secondary cash reserve; and since the company was not a large company, it did not furnish a substantial amount of business, sufficiently substantial to make it financially profitable for the brokers, and they had to be very careful in their relationships. * * * "

We respectfully submit that the facts and circumstances bring this case within the rule that not every redemption and cancellation of stock by a corporation is equivalent to a distribution of a taxable dividend. In *McGuire v. The Commissioner* (CCA 7), 84 Fed. (2d), 431, in construing the application of Section 115 (g), the Court said:

"It is of course not every cancellation or redemption of corporate stock that is taxable, but only if made at such time and in such manner as to be essentially equivalent to a distribution of a taxable dividend. The time and manner are distinct elements pointing to the conclusions of the Board."

In the case of *Harry A. Koch*, 26 BTA 1025, the Board had before it a precisely similar question, and in construing the application of Section 115 (g), to the facts in said case, said:

> "The respondent commissioner determined in his audit of the return and still maintains that the circumstances of the deal are within the provisions of section 115 (g) of the Revenue Act of 1928, and a tax should be paid on the whole amount of $14,350 credited to the petitioner's account as a dividend.
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> * * * * * * * *
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> "The stock disposed of by petitioner was acquired in 1921 not as a stock dividend, but by an assignment of his interest in a partnership. After a lapse of almost eight years the corporation saw fit to redeem part of its outstanding capital stock. The purpose is made clear by the evidence. In 1928 the corporation owed the First National Bank of Omaha about $149,000 on loans. The bank was dissatisfied with the financial statement rendered to support the loan and insisted that it be improved by a reduction of the corporation's outstanding capital stock by $38,000. To comply with this demand, and for no other reason, the corporation adjusted its capital structure in the manner set forth in our findings, which change satisfied the bank in every particular and enabled the corporation to continue its line of credit with the bank.
>
> "Only the petitioner, Friedel, and several of the minority stockholders, participated in the stock redemption. About 11 other stockholders, holding 50 shares, were not parties to the deal. The basis for the redemption was not uniform, the stock of the minority stockholders having been canceled at par, while the credits given the princi-

pal stockholders were on the basis of about $65 per share.

"*The financial condition of the corporation at the time of the stock retirement precluded payment of the agreed purchase price of petitioner's stock in cash. The obligation was liquidated two years later by depreciated securities on the basis of cost to the corporation. Hence, there was neither a stock dividend in the first instance, nor a cash dividend payment in the taxable year.*

"We find nothing in the evidence to bring the transaction within the provisions of section 115 (g) of the governing statute. Accordingly, we hold that the petitioner correctly reported the gain realized on the transaction."

In *Anne Watts Hills*, 27 BTA 73, the Court, in applying the same section, said:

"The statute invites scrutiny of the time and manner of the cancellation or redemption of the stock. It makes no requirement that the issuance and redemption be related; indeed, under its terms the manner of the issuance is not material. *Consequently, we must also scrutinize the redemption and distribution with respect to the time and manner when they occurred and the circumstance surrounding them at that time.*"

We earnestly urge that the facts and circumstances in this case fall within the situation disclosed in the recent case of *Bona Allen, Jr. vs. The Commissioner, 41 BTA 206.* The situation disclosed in that case is on all fours with the facts and circumstances of the instant case, and cannot be distinguished from it. We take the liberty of setting forth that case herein at length.

Bona Allen and his four sons, prior to 1909, conducted a leather business as partners. From that date the business was continued by Bona Allen Inc., a corporation, of which they were the sole stockholders. The only cash dividends that were paid were in July, 1909, September 1918, and June 1922. From 1918 each held 200 shares. One son, H. Wadleigh Allen, died in 1920, and the three brothers are executors of his estate, which continued to hold his stock. In 1925 the charter was amended to authorize 10,000 shares of stock of $100 par value instead of 1,000, and a resolution was passed, reciting that, inasmuch as the entire surplus of the company was needed for permanent operating capital, a stock dividend of $900,000 was declared in stock, out of the surplus. There was legitimate reason for the stock dividend. The stock continued to be owned equally by the father, sons, and the estate of the deceased son, each holding 2,000 shares. In May 1925 the sons, individually, and the estate through them as executors, transferred to the corporation in equal parts 1,200 shares of stock and each received credit for $30,000 though no minutes of stockholders or directors refer to the transaction. The stock surrendered was retained in the company treasury until November 20, 1930. Bona Allen, Sr., died testate October 18, 1925, and his stock was purchased in equal shares of 500 shares each by the three sons and the estate of the deceased son. On November 20, 1930, the corporation purchased certain real estate from the three sons and the estate of the deceased son, paid therefor with the 1,200 shares of treasury stock issued, in equal amounts to the vendors, and $100,000 was placed to the surplus of the corporation, as provided by corporate resolution.

In 1930 the three brothers individually incorporated the Allen Investment Co., the stock of which was paid for by transfer by each brother of 2,500 shares of stock of Bona Allen Inc. The Allen Investment Co., which never engaged in business, was dissolved in 1932, and stock of Bona Allen Inc., was returned to the brothers.

A partnership consisting of the three brothers had been formed in 1923 under the name of V. H. Allen & Brothers. Its business was the ownership and operation of an office building in Atlanta, Georgia, known as the Bona Allen Building. The partners considered the building the corporation's investment, and intended to transfer it to the corporation. The partnership had received at various times advances from Bona Allen Inc. These had from time to time been partly repaid, and on May 31, 1934, the partnership owed the corporation $154,760.53.

The leather business carried on by Bona Allen Inc. required extensive short term borrowing, because of purchase of hides throughout the world. The corporation ordinarily borrowed from banks and through a brokerage house in Boston, through which it obtained loans on commercial paper, at extremely low rates, from ⅝ to 1 per cent. To obtain such loans highest credit standing was required, and an item of prime importance was absence of debts to the corporation from its officers or stockholders, and absence of ownership of encumbered real estate. In 1930 the stockholders of the corporation owed to it about $144,000 and the brokerage house informed the corporation of the adverse effect upon its credit. Again, late in 1931, when the indebtedness stood at about $165,000, the undesirable aspects of the situation were called to the attention of the corporation by the brokerage house, which reported refusal of a St. Louis bank to buy the corporation's paper because of the debt by officers to the corporation and suggested that temporary cessation of offer of the corporation's paper in the market would be to its best interest. In 1932 the indebtedness increased and the brokerage house handled less paper for the corporation, upon an understanding there would be no increase in the indebtedness. In 1933 it decreased slightly and the brokers handled more paper. In 1934 the brokerage house suggested the elimination of the indebtedness by application thereto of proceeds of a surrender of capital stock by stockholders. The major part of the indebtedness was due to advances by the corporation because of the Bona Allen Building, operated, under mortgage, by the partnership.

The brokerage house advised against transfer of the encumbered building to the corporation, and the mortgage company would not allow payment until date of maturity, about 18 months later. On May 21, 1934, the brokerage house wrote the corporation with reference to plans under consideration to reduce capital stock $300,000 at par and to clean up or reduce indebtedness from stockholders, to eliminate permanently items due from officers and stockholders and the permanent financing of the Bona Allen Building without further advances by the corporation to stockholders. All was considered by the brokers from the standpoint of the best credit interests of the corporation.

On May 31, 1934, the estate of the deceased brother was indebted to Bona Allen Inc. in the amount of $75,628.12, principally for advancements to provide support for his wife and children. At that date the executors transferred to the corporation 500 shares of stock and the corporation credited the account with $50,000. The stock certificate has never been canceled and is still held in the treasury of the company.

Likewise on May 31, 1934, the three brothers individually each transferred 500 shares of stock to the corporation, and the corporation credited with $150,000 the $154,760.53 account owing to it by V. H. Allen & Brothers partnership. On May 31, 1934, the corporation had a surplus of $928,809.46 and cash of $116,-919.53.

No reference was made on the minutes of stockholders or directors of the corporation, as to the matters transacted on May 31, 1934, but journal entries thereof were made upon the corporate books, and upon the books of the partnership, showing surrender of 1,500 shares of stock by the partnership, 500 shares by the estate of the deceased son, and credit of $200,000. The stock certificates surrendered have never been marked canceled and are still retained in the treasury of the corporation.

Judge Disney, in holding that the circumstances disclosed in that case did not create a taxable dividend, said:

> "Under all of the above circumstances, does section 115 (g) of the Revenue Act of 1934, apply? Was there redemption of stock at such time and in such manner as to make the redemption essential to the distribution of a taxable dividend? The respondent having determined that the retirement entailed a taxable dividend, the petitioner has the burden to show otherwise.

"We think such showing has been made. Numerous cases have laid down the rule that the statute must be interpreted in the light of the facts in each situation. Decisions are varied, some finding and others denying equivalence to distribution of a taxable dividend. They need not be enumerated. The crux of the matter here is that stockholders were indebted to the corporation, that the corporation's business was such that it required large amounts of money on short term notes and had for several years been in the habit of borrowing, through brokers, such money at extremely low rates of interest, that in order to secure such low interest rates it was necessary to maintain a high credit standard, and that the brokers objected to loans to the stockholders or officers of the corporation. They vigorously urged the elimination of such loans even to the extent of suggesting a cessation of borrowing after one bank, which had been in the habit of lending to the corporation through the brokers, had declined to do so because of the indebtedness of the stockholders.

"At the brokers' suggestion the indebtedness from stockholders was largely eliminated by the redemption of stock in equal amounts from each stockholder. The corporation had always been closely owned, and for nine years there had only been four stockholders, and never more than five. Though the stock redeemed had been issued as a stock dividend, this had been nine years before and for legitimate business purposes. No contention to the contrary seems advanced. Because of the close ownership of the corporate stock by the four stockholders, there seems to have been no great advantage to the stockholders as individuals in the redemption of stock. They continued to own the stock in the same equal proportions.

"The principal advantage to them was the advantage to the corporation in obtaining a better credit rating because of the elimination of indebtedness from stockholders or officers. No reason for the redemption appears except to affect credit relations. No extraordinary profits were present for distribution, such as have in some cases caused conclusion that there was essentially a taxable dividend. The reasons advanced for the redemption of stock are not met by any contrary evidence. We think that the reason given for the transaction is a legitimate business reason. Certainly the obtaining of loans at as low as less than 1 per cent per annum was an important consideration to the corporation and to the stockholders thereof.

"Although respondent suggests that the same result might have been obtained by a cash dividend to the stockholders and the payment of their indebtedness to the corporation, the corporation had on hand cash sufficient to pay little more than one-half of the amount of indebtedness eliminated by the redemption of stock, and the record throughout indicates the necessity for the retention of cash at all times by the corporation so that obviously the corporation could not with safety to its business pay out all of its cash to the stockholders. There is no proof in the record of intent to evade tax.

"The situation, we think, is much like that appearing in *Harry A. Koch*, 26 BTA 1025, wherein it was held that a redemption was not violative of section 115 (g) of the Revenue Act of 1928. Therein the petitioner, president and holder of most of the stock of a corporation, was endorser upon notes given by it to a bank. The bank was not satisfied with the financial statement of the corporation and stated that a more healthy condition would have to be shown and that it would suffice if there were reduction of capital stock. The reduction was accomplished by purchase of shares from the petitioner and smaller amounts from others, and the purchase price of the stock acquired from petitioner was credited to his personal account on the corporate books. This satisfied the bank and it continued to extend credit to the corporation. Here the suggestion of reduction of capital stock, in essentially the same manner as it was carried out, came not from the stockholders but from the loan brokers who were interested in borrowing money from banks and others for the corporation, just as in *Harry A. Koch, supra,* it came from the bank. We there held, in effect, that the reason was valid and based upon business needs, and we think the same applies here.

"In *George A. Lembcke,* 33 BTA 700, we again approved a situation similar to that herein. There, as stated in the headnote:

> " '* * * The evidence disclosed that the increases were made not to disguise later distributions of cash dividends, but for legitimate business purposes, namely, in order to satisfy the demand of banks for a larger capitalization in order to obtain unsecured short term loans necessary for the operation of the business, and in order to satisfy the request of a stockholder anticipating retirement from active participation in the business that the larger portion of the stockholders' investments be placed in preferred stock. Held, that amounts distributed in redemption of the preferred stock were not to be treated as taxable dividends under section 115 (g) Revenue Act of 1928.'

"In the body of the opinion we said:

> " '* * * The corporation was forced by the necessities of its business to borrow a con-

> siderable amount of money from banks on its short term unsecured paper. The banks making these loans preferred that the corporation should have a larger capitalization and felt that the credit which they extended to the corporation would be better secured if such an increase were made. The witness stated that this was one of the reasons for the increase in 1927 and also one of the reasons for the increase in 1929 * * *.'
>
> "We said that such reasons could not be disregarded and that neither the time nor the manner of the redemption indicated an ordinary dividend."

We therefore respectfully submit that the instant case presents a situation squarely within the rule laid down in the *Bona Allen, Jr.*, case. We earnestly contend that a finding that the transaction involved in the instant case is essentially equivalent to a taxable dividend is without any basis of fact to support it.

STATEMENT OF FACTS ON ISSUE II.

Bad Debt Deduction

On June 1, 1925, the petitioner, Max S. Hirsch, loaned to his brother-in-law, Leo W. Seller, $15,000 to enable Seller to establish himself in business in Seattle, Washington. The loan was evidenced by an interest-bearing note dated June 1, 1925, and Seller's stock in the newly organized Garde & Seller's Manufacturing Company was pledged with the petitioner as collateral for the loan. Interest was regularly paid on this loan to September 1, 1930, and the sum of $4400.00 was paid upon the principal as of October 6, 1932.

The Garde & Seller's Manufacturing Company became financially insolvent in 1932, and was compelled to liquidate its affairs. An agreement was entered into between the petitioner, Max S. Hirsch and the debtor, Leo W. Seller, that the proceeds of the liquidation of the Garde-Seller Company be turned over to the petitioner for the purpose of applying same on the indebtedness.

The liquidation of the Garde-Seller Company continued from 1932 and the petitioner received from the time of the insolvency to October 15, 1934, the sum of $5530.76. In 1934 there were still some outstanding accounts receivable which were of uncertain value; the debtor, Seller, at that time also had an equity of at least $2000.00 to $2500.00 in his home in Seattle, which he hoped to realize from its sale, and he had advised Hirsch he would turn over to him any sum realized from the sale of the house to apply on the balance of his indebtedness.

In 1934 the debtor, Leo W. Seller, was in good health, was engaged as a traveling salesman representing various lines of ladies apparel, and was earning approximately $5000.00 gross per year. In the early part of 1935, said Seller suffered a stroke and was unable to continue in his usual line of business. The sale of his real property did not materialize but resulted in a foreclosure in 1938. On December 14, 1935, Seller advised the petitioner that because of his ill health that there was no prospect of any further payments on his note. On December 10, 1935, Edward G. Dobrin, an attorney of Seattle, who was handling the liquidation of the Garde-Seller Company, advised that due to their failure to obtain further remittances from the outstanding accounts that the petitioner should consider that no further recovery could be forthcoming. Upon receipt of the communication from the attorney, as well as the debtor, Leo W. Seller, the petitioner determined that the balance of said indebtedness was worthless, wrote it off on his ledger and charged the balance to profit and loss.

ARGUMENT AND CITATION OF AUTHORITIES ON ISSUE II.

The Board's Finding that the Petitioner, Max S. Hirsch, Did Not Sustain a Deductible Loss in 1935 on Account of the Worthlessness of the Unpaid Balance of Seller's Indebtedness was Not Sustained by Substantial Evidence.

We respectfully contend that the evidence affirmatively establishes that the petitioner, Max S. Hirsch, suffered a deductible loss in the amount of $9469.24 arising out of the Seller loan in 1935, and the identifiable event which established this loss as deductible occurred in 1935, and at no other time. That event was the stroke suffered by Seller, and his definite statement that in view of his health, he could no longer expect to pay anything on the remaining portion of his indebtedness; the advice from Seller that the equity in his property in Seattle, Washington, could not be realized upon; and the final advice of the attorneys in Seattle that under the circumstances no further recovery could be expected from the outstanding accounts belonging to the insolvent Garde-Seller Company. These circumstances were not present in 1934 and we earnestly contend that had the petitioner, Max S. Hirsch, fixed this loss and attempted to deduct the same in his 1934 income tax return, the respondent would have contended (and rightly) that there was no identifiable event in that year, and that there was reasonable opportunity to recover additional sums upon said indebtedness.

It is not suggested that the petitioner did not suffer a loss or that the debt did not exist, but rather that the loss should have been deducted in 1934 rather than in 1935, but we submit that the uncontradicted testimony of the petitioner, Max S. Hirsch, Mr. Seller, and the documentary evidence from the attorneys determined that the identifiable event which fixed the loss occurred in 1935 and not otherwise.

The petitioner had every expectation in 1934 that some additional recovery could be had either from the outstanding accounts, from the sale of the equity in the property, or from the earnings of the debtor, Seller, in his new venture as salesman for a number of apparel houses. In 1935 these expectations were definitely determined to be unfounded and thereupon the petitioner ascertained his loss occurred in that taxable year.

It is of course well established by the authorities that a deduction for a bad debt is allowable only when the taxpayer ascertains it to be worthless, charges it off on his books and takes said deduction for the particular tax year in which it was ascertained and charged off as worthless.

American Savings Bank & T. Co. v. Burnett, (CCA 9) 45 Fed. (2d) 548;

In re Rockwell, 19 BTA 277;

Fidelity Storage Company v. Burnett, 54 Fed. (2d) 526;

Shiman v. Commissioner of Internal Revenue, 60 Fed. (2d) 65.

The case at bar presents to the Board again an application of the harsh rule requiring the taxpayer at his peril to fix the time of a loss or lose the deduction. Both the Board and the courts have endeavored in many cases to lighten the severity of the rule, the employment of which has resulted in inequities, both to the taxpayer and the government. In the very recent case of Will Rogers Estate (*Rogers v. U.S.*, U.S. Dis. Ct. So. Dist. Cal.), 394 CCH Section 9792, Judge Leon R. Yankwich, in a most unusual oral opinion, went so far as to permit a deduction in 1930 for taxes assessed by the British Government for the year 1926. He said:

> "* * * I don't think the law should be interpreted so as to deprive an American citizen, who is compelled to pay an income tax here, of the benefit of income taxes paid in a foreign country merely because the payment was in the form of an added assessment which he couldn't foresee at the time during the taxable year when he paid taxes and which was actually collected later. Otherwise there was a delay. If he had overlooked filing an income tax, you might say it was his own negligence. He paid the tax. They demanded

> more. Not until after 1930, or when the negotiations took place, was he compelled to pay it. He shouldn't be deprived of that by saying 'It is too bad your 1926 tax year is closed, and I can't give you any reduction.' I think that is a very narrow interpretation, and when we are dealing with allowances for Government agencies which no one can avoid, no one in the world can avoid, it seems to me that the interpretation should be one that will allow the deduction whenever it is made, provided it is made in good faith."

Congress recently has given recognition to the unfairness of the rule by the enactment of the provision for mitigation where an error in claiming or failing to claim a deduction was made subsequent to the year 1932. *Internal Revenue Code Sec. 1871.*

It is further well settled that the ascertainment of worthlessness in order to be allowed as a deductible loss, is dependent upon the exercise of sound business judgment based upon as complete information as is practicable under the circumstances.

> *Blair v. Commissioner of Internal Revenue*, 91 Fed. (2d) 992;
>
> *Lauriston Investment Co. v. Commissioner of Internal Revenue*, 89 Fed. (2d) 327.

District Judge Conger in *Durdan v. Commissioner*, (CCA 3) 106 Fed. (2d) 207, said:

> "The identifiable event spoken of by Mr. Justice Stone in *U.S. v. White Dental Co.*, 274 U.S. 398, 401 (1 USTC No. 235) is an event which fixes the present fact of loss 'such as the

> sale of the property * * * its destruction or physical injury.' An event which indicates the imminence of a loss but not the present fact of loss does not meet the test enunciated by the cited authorities."

The decision of Judge Sanborn, in an analogous situation, involving a loss sustained through the sale of corporate assets under a conditional sale contract, is pertinent to the case at bar. In *Stiver v. Commissioner*, 90 Fed. (2d) 505, Judge Sanborn said:

> "While the above statute permits the deduction of losses from gross income, 'it requires such losses be "realized" by some closed and completed identifiable event * * * which definitely settles and determines the existence of and the amount of such loss, * * * and it requires such losses to be actual and real * * * where the identifiable event relied upon to establish a loss is a sale, the transaction must ordinarily be closed and completed in the year in which the deduction is taken' * * * although it is not necessary that a sale of personal property shall be accompanied by delivery if the 'obligation to deliver is so fixed that the loss is reasonably certain in fact and uncertainable in amount' * * *."

The more recent case of *David O. Dunbar v. Commissioner of Internal Revenue*, decided April 21, 1941, 119 Fed. (2d) 367, by the United States Circuit Court of Appeals for the Seventh Circuit, is particularly pertinent to the controversy here involved. That case involved the determination of the question as to whether a loss occurred in 1934 or 1935, and among other things the court stated:

"The taxing act is to be construed most strongly against the government. *Gould v. Gould,* 245 U.S. 151 (1 USTC, paragraph 13).

* * * * * * * *

"In dealing with a loss occasioned by the taxpayer's breach of contract, the Supreme Court said: '* * * no definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test.' *Lucas v. American Code Co.,* 280 U.S. 445 (2 USTC, paragraph 483).

"As the Supreme Court said in *U. S. v. White Dental Company,* 274 U.S. 398, that the taxing act does not require the taxpayer to be an 'incorrigible optimist,' neither does it require him to be an incorrigible pessimist. That the taxpayer, during the crucial period of 1932 to 1935, adopted an optimistic rather than a pessimistic view of the future of the California and Oregon Lumber Company is not, under the circumstances here present, to be condemned.

* * * * * * * *

"We feel that the taxpayer in the instant proceeding not only used good judgment in his appraisement of the situation and in his withholding of a claimed loss until 1935, when total loss became apparent beyond controversy, but has acted in the utmost good faith. No one challenges his asserted loss or that it is complete, but only that he has not claimed it in apt time. He should not be penalized by any technical application of hard and fast rules in the assumption of the burden cast upon him to establish the precise time in which the loss occurred. It is a difficult burden at the best and, in the consideration of whether it has been met, he is entitled to

> that common sense, practical test suggested by the Supreme Court in *Lucas v. American Code Co., supra.*"

Likewise in the instant case we submit that the petitioner, Max S. Hirsch, acted in good faith and with reasonable business judgment in determining that his loss as a result of the Seller loan became total and fixed and beyond controversy in the year 1935 and he is therefore entitled to have the common sense rule applied as was applied in the Dunbar case.

STATEMENT OF FACTS ON ISSUE III.

Exemption as Head of Family and Credit for Dependents

The petitioner, L. B. Hirsch, in his returns for 1935 and 1936 claimed a personal exemption of $2500.00 as head of a family, and a credit of $1200.00 for three dependents. The respondent in his deficiency notice allowed the petitioner a personal exemption only of $1000.00 and disallowed the credit for dependents, which ruling was sustained by the Board of Tax Appeals.

The petitioner is unmarried. Since 1922 he has maintained a home in the City of Portland, Oregon, where he lived with his sister, Eda M. Low, her husband, Julius Low, and their minor daughter, Barbara. The home was purchased by the petitioner but deeded to his sister as a gift in 1922. The petitioner, however, was privileged to mortgage the home whenever he saw fit, and in 1933 the property was mortgaged to secure a loan to the petitioner of $10,000 which he subsequently repaid. During the years 1935 and 1936 the petitioner contributed about $350.00 to $400.00 per month for the general expenses of maintaining the household in which he and the others resided. In addition he paid the medical bills of different members of the household and contributed to the educational expense of the minor daughter, Barbara.

The evidence establishes that in 1929 Julius Low suffered an eye affliction which resulted in permanent blindness. Since said time he was engaged in selling wines and cigars on a commission basis to a few close friends in Portland. He had no office and no established place of business. His earnings did not exceed four or five hundred dollars a year.

The evidence further establishes that for sometime prior and during the years 1935 and 1936 the petitioner, as well as his sister, Eda M. Low and her husband, Julius Low, owned all of the stock of the Hirsch Investment Company, a corporation organized in 1911, with a capital stock of $200,000, but was later reduced to $5000.00. On December 31, 1935, the petitioner owned 27.5 shares, Julius Low 18.75 shares and Eda M. Low 3.75 shares. The principal asset of the corporation was a parcel of improved real estate, consisting of a one-story concrete building which was rented. The net income of this corporation for the year 1935 amounted to $869.78, and in the year 1936 the income was $979.52.

ARGUMENT AND CITATION OF AUTHORITIES ON ISSUE III.

The Board's Finding that the Petitioner, L. B Hirsch, was Not the Head of a Family and Had No Dependents in 1935 and 1936 Within the Meaning of Section 25 (B)-1 and 2 of Revenue Act of 1934 and 1936 Are Not Supported by Any Evidence.

We respectfully submit that upon the evidence adduced at the trial the finding of the Board that the petitioner, L. B. Hirsch, is not entitled to a personal exemption as head of a family is not supported by any substantial evidence and is not in accordance with the law.

It is to be noted that the petitioner is over 65 years of age, has never married, and since 1928 has maintained a home wherein lived his sister, Mrs. Low, her husband, Julius Low, and their minor daughter, Barbara; that since 1930, Mr. Julius Low had become virtually blind, and has lost his ability to earn an income in his regular occupation. That his average earnings during the past number of years, and during the taxable years in question, did not exceed $400.00 per year. That the petitioner had paid all of the ordinary household requirements, such as food, clothing, medical expenses, fuel, heat and all of the other expenses necessary to maintain a home upon a decent standard of living. His testimony, uncontradicted, is that the cost of maintaining this home for himself and his sister, brother-in-law and niece, averaged between four thousand and five thousand dollars per year. That the brother-in-law, on account of his affliction, contributed to the maintenance of this home not more than $400.00 per year.

Conceding, for the sake of argument, that the income from the Hirsch Investment Company added an additional six or seven hundred dollars per year, the total contribution from Mr. and Mrs. Low from all sources towards the maintenance of the home did not exceed One Thousand dollars per year, less than one-fourth of the total amount, testified to by the petitioner that he expended in the maintenance of said household.

We submit that in the light of the physical affliction of Mr. Low that the petitioner was under a moral duty to support and maintain his relatives rather than to permit them to become objects of charity. Not one scintilla of evidence was introduced to disprove the testimony of the petitioner that he had maintained this household for the past number of years, and not a scintilla of evidence was introduced to contradict the petitioner in his testimony that he had paid for the education of his niece, Barbara.

It is significant that S. R. Stockton, Internal Revenue Agent in his field conference report (Respondent's Exhibit J), of November 2nd, 1936, after a complete investigation of the claim made by the petitioner, recommended that he be allowed the exemption as the head of a household. It stated:

> "This taxpayer is a single man. In 1922 he purchased a house and took with him to live therein his sister, who at this time is 48 years of age, his brother-in-law, now age 65, and a niece now age 15. At the time the house was purchased by this taxpayer it was encumbered by a mortgage which he afterwards paid off. For personal reasons he transferred title to the property to his sister, Mrs. Low. After the transfer, the taxpayer found it necessary to borrow money as security for which a mortgage on the property was again given. The taxpayer was, during the year under review, and is at this time paying off this mortgage.
>
> "During the year under review the taxpayer's brother-in-law was almost totally blind but had recovered from blindness sufficiently to enable him to make doddering trips about the City of Portland peddling cigars to friends and acquaintances. The taxpayer's sister manages the household, most of the manual work being done by servants. Except for the income made by the brother-in-law in the sale of cigars, which during the year under review amounted to $463.42, none of the family have any income except the taxpayer. In the return filed by him, he included in his income the $463.42 which had been earned by the brother-in-law and deducted taxes and interest on the house which in reality is his property but which is held in the name of his sister. The expense of maintaining the home for the year exceeded $4,000.00."

Article 25-4 of Regulations 86, provides:

> "Personal exemption of head of family—A head of a family is an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation."

We contend that in the light of the evidence the petitioner was under a strong moral obligation to support his sister and her minor child, when neither was engaged in any occupation and could not depend upon support from the husband who was virtually blind.

The case at bar is precisely analogous to the case of *Alfred E. Fuhlage*, 32 BTA 222. In that case the petitioner was a single man and was the sole support of his unmarried sister, age 55, whom he maintained in his household and who had no trade, occupation or income. In holding that the petitioner in said case was entitled to an exemption as the head of a household, the Board stated:

> "Article 292 of Regulations 74, promulgated under the Revenue Act of 1928, is set forth in the margin. This portion of the regulations is not in conflict with the statute, but is a fair interpretation thereof. It, therefore, has the force and effect of law. *Maryland Casualty Co. v. United States*, 251 U.S. 342. This provision of the regulations is the same as corresponding provisions of prior and subsequent regulations, and the fact

that Congress has continued to reenact, in the successive revenue acts, the provisions regarding the personal exemption of the head of a family, without change, is persuasive evidence of legislative approval of the regulations. *Brewster v. Gage*, 280 U.S. 327; *Helvering v. Bliss*, 293 U.S. 144.

"In the instant proceeding the evidence shows that during the year in question the petitioner actually supported and maintained in his household his unmarried sister, age 55 years. In our opinion, the petitioner's right to exercise family control and provide for his dependent sister was based upon a moral obligation. He was her sole support. She had no trade or occupation and had no income. It is our conclusion that the petitioner is entitled to a personal exemption of $3,500 as the head of a family. *Paul Polichroniades*, 2 BTA 1263.

"*W. E. Massey*, 14 BTA 407, affirmed in *Massey v. Commissioner*, 51 Fed. (2d) 76, is distinguishable. There we held the taxpayer was not entitled to an exemption as the head of a family where his sister, 43 years of age, lived with him and supervised the running of the household. The taxpayer there paid the expenses of the home and also his sister's expenses. Upon the evidence there we held, in effect, that the taxpayer's sister had the status of an employee, rather than a dependent. See *Massey v. Commissioner, supra.* This is not true in the instant proceeding. It is true that it is stipulated that the petitioner's sister 'acted as petitioner's housekeeper.' However, the meaning of the word 'housekeeper' is not limited to one who is employed (see Webster's New International Dictionary, 1929); and the other stipulated facts show that she was not employed by the petitioner. Among other things it is stipulated that during the year in question he was her sole support and maintained her, and that she had no trade or occupation and had no in-

> come. Furthermore, the petitioner did employ a servant during the year in question. Under the circumstances we consider it only natural that a feeling of gratitude or an interest in the household would prompt the sister to act as housekeeper. The only inference to be drawn in view of all of the stipulation, covering this period, is that what she did in this respect, was done gratuitously. There are numerous facts appearing in the instant proceeding which were not present in *W. E. Massey, supra.*"

In *Lowry v. Commissioner*, 11 BTA 409, the petitioner claimed an exemption as head of a family. The Commissioner disallowed said exemption. In reversing the findings of the Commissioner, the Court said:

> "The petitioner was the head of a family and his granddaughter under eighteen years of age, was entirely dependent upon him for support. He was therefore entitled to a personal exemption of $2200.00 for each of the taxable years 1919 and 1920."

The Respondent does not contend that the petitioner, L. B. Hirsch, did not contribute substantially three-fourths of the necessary amount required to maintain the household, but he suggests that because Mr. and Mrs. Low had a 45% stock interest in the Hirsch Investment Company, that somehow they were not dependent upon the petitioner, but were financially independent of him. We submit that there is not an iota of evidence to support that contention. It is true that Mr. and Mrs. Low had a 45% stock interest in the Hirsch Investment Company, which corporation owned a parcel of real property from which it derived certain rentals, but the fact is that the entire income of the Hirsch Investment Company for the year 1935 amounted to $869.78, of which 45% or $391.40, belonged to the Lows, and in the year 1936, the entire income of the Hirsch Investment Company was $979.52, of which 45% or $440.78 belonged to the Lows. To this income Mr. Low testified that he earned approximately $300.00 per year from selling cigars and wines to private customers, and Mrs. Low received an additional quarterly dividend on Associated Gas Stock of $41.10, the aggregate total of income from the Hirsch Investment Company, the earnings of Mr. Low, and the dividend on Associated Gas Stock was less than $800.00 for either of the years in question.

It is interesting to note that the respondent bases his disallowance of the exemption upon the fact that the Hirsch Investment Company had considerable assets which were available to the stockholders. Indeed, the respondent urged upon the Board that the net worth of the corporation on December 31st, 1935, was more than $17,000.00 but what he failed to do was point out (see Respondent's Exhibit F), that the item of accounts receivable in the sum of $28,492.13 represented accumulated past borrowings of the stockholders kept on the books of the corporation since its organization in 1911, and that the only asset of the Hirsch Investment Company was represented by the piece of property valued at approximately $32,000.00 against which there was an outstanding mortgage of some $20,000.00. The only cash possessed by the Hirsch Investment Company at the end of 1935 was in the sum of $562.28. The respondent, therefore, would have this court believe that before Mr. and Mrs. Low, and their daughter, can be considered dependent upon the petitioner, they should first endeavor to realize from the sole asset that they possessed, irrespective of whether there was a market for it or not. We do not believe that that constitutes any test of dependability.

The respondent further contends that the petitioner exercised no "parental control," and that neither was the petitioner the legal guardian of his niece. The authorities do not require, in order that one may be considered as "head of a family," that he exercise parental control, or that he be appointed a legal guardian. We understand the rule to be, as contained in Article 25-4 of Regulations 86, namely:

> "That a head of a family is an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship and whose right to provide for these dependent individuals is based upon some moral or legal obligation."

CONCLUSION

We respectfully submit that the evidence overwhelmingly establishes, and the authorities fully support, the following conclusions:

(1) That the cancellation or redemption of the stock by the petitioners, Max S. Hirsch and L. B. Hirsch, under the circumstances set forth in the record before this court must be construed within the meaning of Section 115 (g) of the Revenue Act of 1934 as not constituting a taxable dividend and the holding of the Board that same was a taxable dividend is not supported by substantial evidence and is contrary to the law and should be reversed.

(2) That the evidence conclusively establishes that the petitioner, Max S. Hirsch, was entitled to a deductible loss arising out of the Leo W. Seller loan in 1935 and the conclusion of the Board that the deductible loss was not incurred in the year 1935 is wholly unsupported by any substantial evidence and is contrary to law and should be reversed.

(3) That the petitioner, L. B. Hirsch, was entitled in his income tax returns for 1935 and 1936, a personal exemption as the head of a household and credit for dependents under the circumstances and evidence adduced at the trial, and that the holding of the board

that he was not entitled to such an exemption as head of the household is not supported by any evidence whatever and is contrary to law and should be reversed.

Respectfully submitted,

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